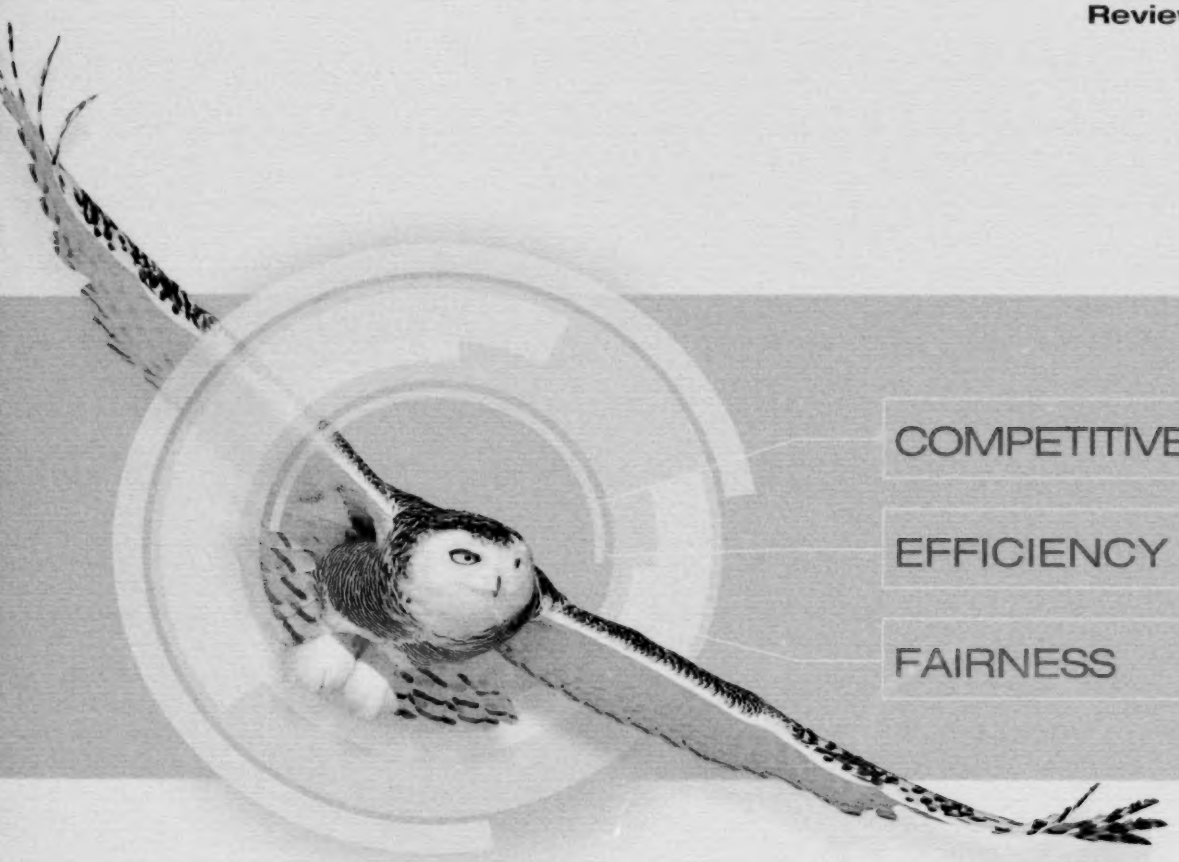
Final Report of the
Québec Taxation
Review Committee



FOCUSING ON QUÉBEC'S FUTURE

VOLUME 4

Documents Submitted
During the Mandate

Québec

Final Report of the
Québec Taxation
Review Committee

March 2015

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VOLUME 4

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During the Mandate

Commission
d'examen
sur la fiscalité
Québec

Final Report of the Québec Taxation Review Committee

FOCUSING ON QUÉBEC'S FUTURE
Volume 4 – Documents Submitted During the Mandate

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INTRODUCTION

The government created the Québec Taxation Review Committee in June 2014.[1]

After eight months of deliberations, the committee has filed its final report, comprised of a summary and six volumes.

Volume 1, ***Québec Tax Reform***, presents the contents of the proposed reform. It examines in turn the challenges, principles and objectives that guided the committee, the key characteristics of the reform, its adjustment over time and an estimate of the anticipated impact.

Volume 1 provides a brief description of the six volumes of the report.

❑ Volume 4

This document, Volume 4, entitled ***Documents Submitted During the Mandate***, is comprised of the two documents prepared by the Québec Taxation Review Committee that were submitted to the government prior to the tabling the final report.

Accordingly, this volume is divided into two sections:

— the **interim report** tabled on **October 31, 2014**;

— the analysis of the rates for reduced-contribution childcare services, entitled **Excerpt from the Final Report: Funding of Reduced-Contribution Childcare Services**, submitted on a preliminary basis to the Minister of Finance, at his request, on November 18, 2014.

1 The establishment of the Québec Taxation Review Committee to analyze, and propose the reform of, the Québec taxation system was announced by the Premier in his May 21, 2014 inaugural speech at the opening of the 41st Legislature of the National Assembly, and subsequently confirmed in Budget 2014-2015. The order in council of June 11, 2014 officially created the Québec Taxation Review Committee and stipulated its mandate.

OCTOBER 31, 2014
INTERIM REPORT

QUÉBEC TAXATION REVIEW COMMITTEE

COVER LETTER FROM THE COMMITTEE

October 31, 2014

Mr. Carlos Leitão,
Minister of Finance
Ministère des Finances
12, rue Saint-Louis
Québec

Dear Minister:

In accordance with the mandate entrusted to the Québec Taxation Review Committee by the government on June 11, 2014, you will find attached the interim report proposing tightening measures, with a view to achieving the targets set in Budget 2014-2015.

We hope that the report meets your expectations.

Yours truly,

Luc Godbout
Chair, Québec Taxation Review Committee

Committee members

Dana Ades-Landy

Pierre-Carl Michaud

Danièle Milette

Yves St-Maurice

Jean-Pierre Vidal

Luc Villeneuve

Carole Vincent

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INTRODUCTION

The government created the Québec Taxation Review Committee in June 2014.[2] The committee's final report is expected by December 31, 2014.

❑ Committee's mandate

The order in council establishing the committee states that the committee must submit to the government, no later than October 31, 2014, an interim report proposing tax expenditure changes, applicable in the short term, enabling the government to achieve ongoing savings of $150 000 000 in 2014-2015 and $650 000 000 as of 2015-2016.

This is that interim report.

■ Three-pronged approach

This report is part of the overall reflection undertaken by the Québec Taxation Review Committee.

On the basis of its mandate, the committee has taken a three-pronged approach to identifying tax initiatives:

— immediate tightening of tax expenditures;

— reform of the Québec taxation system in the short, medium and long term that entails no costs for taxpayers[3] as a whole and that is cost-neutral for public finances;

— once budget balance has been restored, identification of priority tax relief to be granted out of amounts that can generated within the financial framework.

The initiatives proposed under this approach must be consistent with one another.

The interim report is essentially focused on identifying a series of measures to immediately tighten tax expenditures.

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2 The establishment of the Québec Taxation Review Committee to analyze, and propose the reform of, the Québec taxation system was announced by the Premier in his May 21, 2014 inaugural speech at the opening of the 41st Legislature of the National Assembly, and subsequently confirmed in Budget 2014-2015. The order in council of June 11, 2014 officially created the Québec Taxation Review Committee and stipulated its mandate.

3 "Taxpayers" refers to both individuals and corporations.

The order in council to create the Québec Taxation Review Committee

The establishment of the Québec Taxation Review Committee to analyze, and propose the reform of, the Québec taxation system was announced by the Premier in his May 21, 2014 inaugural speech at the opening of the 41st Legislature of the National Assembly, and subsequently confirmed in Budget 2014-2015.

Mandate

The order in council of June 11, 2014 officially created the Québec Taxation Review Committee and stipulated its mandate.

The mandate is defined as follows:

- examine all tax measures on the basis of relevance and efficacy, in order to identify measures to reduce overall tax expenditures for the purpose of meeting the targets set in Budget 2014-2015;
- examine the Québec taxation system to enhance its efficiency, fairness and competitiveness, and ensure funding for public services;
- compare international taxation trends, in particular with respect to the practices of proximate neighbours such as the United States and the other Canadian provinces;
- examine the possibility of rethinking balance between different modes of taxation;
- attentively review the business taxation system to propose avenues that will better support economic growth;
- analyze the personal income tax system, in particular to further encourage work and saving and optimize user fees while ensuring fair redistribution of collective wealth by maintaining adequate support for the poorest members of society;
- assess the possibility of subjecting to taxation certain user fees, in order to take into account the ability to pay of users of public services, bearing in mind the impacts on the implicit marginal taxation rates.

Commissioners

The Québec Taxation Review Committee is chaired by Luc Godbout, full professor at the Département de fiscalité of the Université de Sherbrooke.

Apart from the chair, the committee is composed of the following members:

- Dana Ades-Landy, Vice-President, Scotia Bank;
- Pierre-Carl Michaud, associate professor, Département des sciences économiques, Université du Québec à Montréal;
- Danièle Milette, tax specialist;
- Yves St-Maurice, economist;
- Jean-Pierre Vidal, CPA, CA, associate professor of taxation, HEC Montréal;
- Luc Villeneuve, FCPA, FCA, Chairman, Deloitte – Québec;
- Carole Vincent, economist, consultant and researcher in economics.

❑ "Tax expenditure" defined

The Québec Taxation Review Committee favours a broad definition of "tax expenditure."

By "tax expenditure," the committee means any measure that is introduced in the *Taxation Act* to ease the tax burden of taxpayers and that, as a result, reduces the government's tax revenues.

Concept of tax expenditure

According to the Ministère des Finances du Québec, the concept of tax expenditure refers to policy choices by which the government agrees to forgo part of its tax revenues used to achieve its objectives.[1]

More specifically, what the Ministère des Finances calls tax expenditures are measures that reduce or defer taxes payable by taxpayers. Tax expenditures are therefore exceptions to a standard or reference defined as the basic taxation system. Any measure that provides tax relief deviating from the basic taxation system constitutes a tax expenditure.[2]

The Ministère des Finances emphasizes that tax measures can be interpreted in different ways and that perceptions may result in divergent opinions on what should be included in the basic taxation system. The exercise is therefore partly subjective.[3]

1 MINISTÈRE DES FINANCES DU QUÉBEC, *Dépenses fiscales – Édition 2013*, March 2014, p. A.13.
2 *Ibid.*, pp. A.3 and A.4.
3 *Ibid.*, p. A.4.

❑ A report intended solely for the government

The interim report is intended solely for the government, which agreed not to release it until the final report is tabled.

The Québec Taxation Review Committee has always understood that its primary mandate is to propose a reform of the Québec taxation system in the short, medium and long term that entails no costs for taxpayers as a whole and that is cost-neutral for public finances.

However, budgetary imperatives led the government to also ask the committee to identify measures for reducing overall tax expenditures, in order to achieve the targets set in Budget 2014-2015.

This interim report stems from that requirement.

■ Concerns raised by premature publication of the interim report

The Québec Taxation Review Committee is concerned about the consequences of premature publication of the interim report. Ideally, the committee would have liked to tie in the portion of its mandate concerning tightening measures with the broad-based reflection undertaken for the purpose of proposing taxation reform; that reflection will be discussed in the committee's final report. The committee notes that current constraints preclude this.

Without that overall vision and the reform proposed by the committee, this interim report could be misunderstood. Since the interim report puts forward only immediate tightening measures, it could crystallize the perception that the committee's sole objective is to generate additional tax revenues.

However, the committee's mandate is much broader. As a result, premature publication of this report could undermine the credibility of both the government and the Ministère des Finances, as well as that of the committee, with respect to the nature of the reflection under way.

That said, the committee will include this interim report in an appendix to its final report.

■ Measures that are not an indication of the reform to be proposed

The proposed tightening measures are not an indication of the reform that will ultimately be recommmended by the committee.

Some measures would be temporary. Others could be extended and contribute to generating amounts to fund the reform otherwise proposed.

❑ Links with the Ongoing Program Review Committee

The government undertook a comprehensive collective reflection on the effectiveness of programs and the funding of public services, within the framework of the Ongoing Program Review Committee.

The deliberations of the Ongoing Program Review Committee and the Québec Taxation Review Committee focus on the budgetary and taxation sectors, which, in some respects, are interdependent. Accordingly, the committees ensured that links were established between them.

Recommendations pertaining to both the taxation approach and the budgetary approach must be assessed as a whole. Converting a taxation measure to a budgetary measure, or vice versa, does not necessarily generate new revenues for the government. The analysis must be holistic and result in a net impact.

❑ Plan of the report

In compliance with one of the requirements of its mandate, the Québec Taxation Review Committee is tabling its interim report presenting *proposals for tightening tax expenditures, with a view to achieving the targets set in Budget 2014-2015.*

The interim report is divided into three sections:

— In Section 1, the committee explains *the logic followed* in the choice of the proposed tightening measures.

— Section 2 presents the committee's *proposed* tightening *measures.*

— In Section 3, the committee discusses the *impact of the proposed measures.*

SECTION 1:
THE LOGIC FOLLOWED

The Québec Taxation Review Committee believes it is important to state, at the outset, the logic it followed in analyzing and evaluating the tightening measures.

The tightening measures proposed to the government were identified on the basis of the following elements.

❑ A limited number of clear, readily understandable measures

The committee identified clear, readily understandable measures. Since the interim report is not a public document and the final report will not be discussed publicly until a later date, it was important to the committee that the measures presented be evaluated in their own right, independently of one another, and that they make no presumptions as to the recommendations of the final report.

The committee has undertaken a complete and methodical examination of all tax expenditures, with a view to the recommendations it will make in its final report. Such an examination takes time. For the purposes of the interim report, the committee voluntarily restricted itself to a limited number of general measures or directions with sufficient impact to generate the revenues sought.

The alternative would have been to proceed parametrically, by proportionately reducing the rate of all tax credits, with no special treatment, which the committee ruled out immediately.

❑ Compliance with certain criteria

The Québec Taxation Review Committee used the following criteria to identify a limited number of measures:

— The committee first looked at how corporate taxation measures could be tightened, in keeping with the desire expressed by the Minister of Finance in interventions at the National Assembly during the examination of Budget 2014-2015.[4]

— In the case of personal taxation measures, the committtee prioritized general measures pertaining to a large number of taxpayers. In so doing, the committee sought to distribute the effort required and lessen the anticipated impact on each taxpayer concerned.

— The committee strove to choose measures that would generate the required revenues in the time allocated. This choice flows directly from the committee's mandate. It was key that the proposed measures yield the expected savings as of the current year, and that the savings reach $650 million in 2015-2016.

4 http://www.assnat.qc.ca/fr/travaux-parlementaires/assemblee-nationale/41-1/journal-debats/20140605/112387.html

SECTION 2:
PROPOSED MEASURES

❑ Nature of the proposed measures

In its analysis, the Québec Taxation Review Committee prioritized measures to tighten tax expenditures pertaining to corporations. It identified the following four tightening measures:

— in the case of large businesses, termination of full refundability of corporate tax credits;

— establishment of a minimum threshold respecting qualified expenditures for research and development tax credits and the investment tax credit;

— termination of the enhancement of the research and development tax credits for private partnerships, research consortiums and university research;

— termination of the reduction in the rate of the tax on capital of insurance corporations applicable to personal insurance premiums.

As was the case with the measures to tighten corporate tax credits announced in June 2014, the full impact of measures to tighten corporate tax expenditures is not generally felt on the government's finances until two years after the implementation of the measures. This is due to the accounting rules relative to the end of corporate fiscal periods.

As a result, the proposed measures generate smaller savings for the current year and for 2015-2016. In the short term, the measures therefore fall short of achieving the targets set.

To meet the government's targets, the committee identified two other tightening measures:

— a measure to tighten consumption tax expenditures that applies to both individuals and corporations: standardization at 9% of the rate of the tax levied on automobile insurance premiums;

— a temporary measure applicable to individuals: postponement by one year of the planned 2015 indexation of the main parameters of the personal income tax system.

To achieve the target set, the committee recommends adding an additional revenue measure—an increase in the QST rate from 9.975% to 10%—to these six tightening measures.

❑ Seven measures divided into four groups

The Québec Taxation Review Committee therefore proposes seven measures that fall into four categories:

— four measures to tighten tax expenditures pertaining to corporations;

— a measure to tighten consumption taxes;

— a temporary measure concerning individuals;

— an additional revenue measure.

1. MEASURES TO TIGHTEN TAX EXPENDITURES PERTAINING TO CORPORATIONS

The Québec Taxation Review Committee identified four measures to tighten tax expenditures pertaining to corporations:

— in the case of large businesses, termination of full refundability of corporate tax credits;

— establishment of a minimum threshold respecting qualified expenditures for research and development tax credits and the investment tax credit;

— termination of the enhancement of the research and development tax credits for private partnerships, research consortiums and university research;

— termination of the reduction in the rate of the tax on capital of insurance corporations applicable to personal insurance premiums.

These four measures would enable the government to reduce tax expenditures by $41 million in 2014-2015 and $305 million in 2015-2016.

The full impact of the measures would be felt in 2016-2017, with a recurring $565-million decrease in tax expenditures.

1.1 In the case of large businesses, terminate full refundability of corporate tax credits

The first corporate tightening measure concerns the refundability of corporate tax credits.

❑ A characteristic of most corporate tax credits

Refundability is a general characteristic of most corporate tax credits.

In 2011, tax credits applicable to corporate income tax cost $1.919 billion. Eighty-two per cent of that amount was refunded.[5] This means that a very large portion of the tax credits claimed by corporations exceeded the amount of income tax payable, entitling the corporations to refunds.

The concept of refundable tax credits is not specific to Québec; other jurisdictions also offer refundable tax credits to support specific activities. However, Québec stands apart in its use of this type of support, given that corporate tax credits are generally refundable.

❑ A characteristic with certain undesirable economic impacts

The refundability of corporate tax credits has certain undesirable economic impacts.

Many businesses benefit from the refundability of corporate tax credits on a recurring basis, because their income tax payable year over year is lower than the value of the credits.

That corporations do not generate sufficient profits over a long period of time to capitalize on the tax credits available to them is undesirable. Refundable tax credits do not incite businesses to generate profits.

In the longer term, this situation also deprives Québec of the creation of greater value-added and the resulting benefits.

5 Amount of the tax credit that exceeds the amounts paid by the corporation as corporate income tax, tax on insurance premiums and compensation tax for financial institutions, without taking into account the remittance of the contribution to the Health Services Fund. When the contribution to the Health Services Fund is also taken into account, the portion refunded drops to 56%.

❑ Recommendation

In the case of large businesses,[6] the Québec Taxation Review Committee recommends that full refundability of corporate tax credits be terminated.

■ Protecting smaller busineses

The committee believes that smaller businesses, which could experience cash-flow problems further to termination of the refundability of the tax credits, must be protected.

Accordingly, the committee recommends that the principle of tax credit refundability be maintained in the following cases:

— Canadian-controlled private corporations with taxable income under $500 000 and consolidated world paid-up capital under $10 million: the first one million dollars of the tax credits is refundable with respect to these corporations;

— Canadian-controlled private corporations with taxable income between $500 000 and $800 000 or consolidated world paid-up capital between $10 million and $50 million: refundability applies to the first bracket of the tax credits, the amount of which is reduced linearally from $1 million to zero between these thresholds.

For all other corporations, refundability would be eliminated.

■ Factoring in the contribution to the Health Services Fund

The Québec Taxation Review Committee further recommends that, in addition to income tax, the contribution to the Health Services Fund be factored into the determination of the tax credits for all corporations.

This measure would mitigate the impact of terminating the refundability of the tax credits.

Factoring in the full amount of a business's contribution to the Health Services Fund would be of special interest to the research and development sector. For example, manufacturing enterprises active in research and development but whose main activity is manufacturing would be able to apply research and development tax credits, calculated solely on the payroll qualifying for the credits, to the contribution to the Health Services Fund paid on the business's total payroll. As a result, these businesses would be able to take full advantage of research and development assistance.

The committee would like to maintain substantial support for research and development activities, because of the positive externalities generated by them.

6 By "large business," the committee refers to a corporation whose world paid-up capital is over $50 million.

❑ Impact on businesses

As evaluated by the Ministère des Finances, eliminating the refundability of the tax credits according to the guidelines suggested by the Québec Taxation Review Committee would affect nearly 700 of the 11 800 corporations for which a portion of the tax credits is currently refundable. Thus, taking into account the exceptions defined above, refundability of the tax credits would continue to apply to approximately 94% of corporations.

■ Termination of refundability would not spell the end of the tax credits

Termination of the refundability of the tax credits for large businesses would not spell the end of the tax credits themselves.

Non-refundability consists in limiting the tax credit amounts a taxpayer may claim to the taxpayer's tax expenses for a taxation year. If the applicable tax expenses are sufficient, non-refundability does not decrease the amount of a business's tax credits.

In the case of non-refundable tax credits, corporations whose total tax on profits or contribution to the Health Services Fund is not sufficient for them to claim the full amount of a tax credit may, in certain instances, carry over the unused portion of the tax credit to their tax expenses in subsequent years, by means of a mechanism analogous to the loss carry-over mechanism.

In making the tax credits non-refundable, the government would only defer the time when a corporation may claim them, provided, of course, the corporation generates enough profits to do so.

The proposed measure would primarily affect corporations that, year over year, do not generate enough tax on profits or a sufficient contribution to the Health Services Fund for the purposes of the current refundable tax credits. The proposed tightening measure should encourage corporations engaged in activities in several jurisdictions to report a larger share of their profits in Québec.

❑ Savings generated

The proposed measure would generate savings of:

— $5 million in 2014-2015;

— $135 million in 2015-2016;

— $365 million as of 2016-2017 and on a recurring basis in subsequent years.

These savings would not be called into question if corporations increased their profits. In that case, the tax credits would be paid on the new tax revenues stemming from the additional profits.

❑ Possibility of a gradual or adjusted application

If the government were to tighten the tax measures identified by the Québec Taxation Review Committee, a major change for corporations would result.

The public consultations that ended just before the tabling of this interim report showed the committee how sensitive certain sectors or industries are to the types of tax changes proposed.

To curtail the anticiated impact, the government could choose to gradually terminate the refundability of tax credits for large businesses. The government could also decide to adjust the application of the measure to take into account the specific situations of certain sectors.

If the government maintains its short-term reduction target for corporate tax expenditures, it will have to come up with one or more temporary measures to offset the tightening measures that are not implemented immediately.

1.2 Establish a minimum threshold respecting qualified expenditures for research and development tax credits and the investment tax credit

The second tightening measure pertaining to corporations concerns specfic tax credits—research and development tax credits[7] and the investment tax credit.

❑ Small expenditures respecting which the tax credit is not a determining factor

Research and development tax credits and the investment tax credit are intended to encourage research and development activities or investments that would not otherwise have been carried out or made.

The Québec Taxation Review Committee noted that many businesses claim these tax credits for small amounts. In 2011:

— 1 673 businesses, that is, 21% of businesses that received tax credits for research and development, had qualified expenditures under $25 000.

— 2 492 entreprises, that is, 60% of businesses that received the investment tax credit had qualified expenditures under $50 000.

These are such small amounts that they can hardly be considered actual investment or research and development expenditures. They are likely expenditures respecting which the tax credits are not a factor in the business decision.

7 Research and development tax credits group the tax credit for researchers' salaries, the tax credit for a research contract entered into with a university, an eligible public research centre or a research consortium, the tax credit for private partnership research and the tax credit for fees and dues paid to a research consortium.

❑ Recommendation

The Québec Taxation Review Committee recommends the establishment of a minimum threshold respecting qualified expenditures for research and development tax credits and the investment tax credit.

Research and development tax credits would be available only on:

— the amount in excess of the first $10 000 of research and development expenditures, in the case of corporations with assets under $50 million;

— the amount in excess of the first $25 000 of research and development expenditures, in the case of corporations with assets over $75 million.

Between these two amounts, the exclusion bracket would increase linearly from $10 000 to $25 000.

The investment tax credit would be available only on:

— the amount in excess of the first $10 000 of investment expenditures, in the case of corporations with paid-up capital under $250 million;

— the amount in excess of the first $50 000 of investment expenditures, in the case of corporations with paid-up capital over $500 million.

Between these two amounts, the exclusion bracket would increase linearly from $10 000 to $50 000.

❑ Savings generated

The proposed measure would generate savings of:

— $1 million in 2014-2015;

— $25 million in 2015-2016;

— $45 million as of 2016-2017 and on a recurring basis in subsequent years.

1.3 Terminate the enhancement of the research and development tax credits for private partnerships, research consortiums and university research

The third tightening measure pertaining to corporations concerns three enhanced tax credits respecting certain research and development activities.

❑ A generous enhancement

The research and development tax credit for researchers' salaries gives entitlement to a credit whose rate varies with a corporation's size. The rate is a minimum of 14% for corporations with assets over $75 million and reaches 30% for enterprises with assets under $50 million.

Tax credits at a higher rate, 28%, are offered regardless of a corporation's size, in the case of:

— private partnership research;

— research consortiums;

— university research contracts.

Québec is the only jurisdiction that offers such an enhancement, and the general credit is already among the most generous in Canada. There appears to be little justification for the enhancement.

❑ Recommendation

The Québec Taxation Review Committee recommends that the enhancement of these tax credits be abolished.

The abolishment would not spell the end of research and development assistance. Such activities would henceforward qualify for the research and development tax credit for researchers' salaries.

❑ Savings generated

The proposed measure would generate savings of:

— less than $1 million in 2014-2015;

— $15 million in 2015-2016;

— $25 million as of 2016-2017 and on a recurring basis in subsequent years.

1.4 Terminate the reduction in the rate of the tax on capital of insurance corporations applicable to personal insurance premiums

The fourth tightening measure pertaining to corporations concerns the tax on insurance premiums paid by insurance corporations as tax on capital.

❑ Currently a reduced rate

Currently, the Québec taxation system provides that insurance corporations must pay tax on capital, which is in the form of a tax on insurance premiums.

— The rate of the tax is 3% in the case of damage insurance.

— The rate drops to 2% in the case of insurance of persons.

This lower rate has all of the hallmarks of a tax expenditure, compared to the general rate of 3%. The Québec Taxation Review Committee therefore identified the measure as one that could possibly be tightened.

❑ Recommendation

The Québec Taxation Review Committee recommends the termination of the reduced rate by raising the rate applicable to personal insurance to 3%, the same rate collected for damage insurance. Accordingly, a standard rate of 3% would apply to all types of insurance premiums, without distinction.

The elimination of this tax expenditure would have a recurring impact. The full impact of the measure would be felt as of 2015-2016.

❑ Savings generated

The proposed measure would generate savings of:

— $35 million in 2014-2015;

— $130 million as of 2015-2016 and on a recurring basis in subsequent years.

❑ A limit on tightening measures pertaining to corporations

The Québec Taxation Review Committee did not identify, based on the aforementioned criteria,[8] other immediate measures for tightening corporate tax expenditures that would enable the targets to be achieved.

Given the time gap between the announcement of the measures to tighten corporate tax expenditures and their full impact on public finances, announcements with a much more significant impact on full implementation would be required to achieve a target of $650 million in 2015-2016 solely by tightening corporate measures. To attain $650 million in 2015-2016, the corporate tightening measures would have to reach over $1.8 billion, the equivalent of cutting all tax credits, tax holidays and other measures for businesses.

Measures of that scale cannot be considered.

Another option would have been to apply retroactive tax changes, which the committee refused to contemplate.

Time gap in the application of corporate tax measures

As part of Budget 2014-2015 in June 2014, the government announced measures to reduce tax assistance for businesses.

An examination of the impact of the measures shows the time gap between the implementation of corporate tax measures and their full impact on public finances.

The full impact of the measures will not be felt until three years after their implementation, the impact being:

- $104 million the first year, 2014-2015;
- $348 million the second year, 2015-2016;
- $496 million the third year, 2016-2017.

This time gap is explained by two factors:

- variation in the end date of the fiscal periods of corporations;
- the time required to file the income tax return and pay any resulting refund.

For the full impact of a tax measure to be felt, each corporation must have gone through a complete fiscal period following the implementation of the measure.

- A corporation whose fiscal period begins at the same time the tax change takes effect will have gone through a complete fiscal period with respect to the change 12 months after the change is introduced.
- At the other extreme, a corporation whose fiscal period ends one month after the tax change takes effect will not have gone through a complete fiscal period further to the change until 23 months later.

After that date, a time period must be established for filing the income tax return and receiving a refund. A maximum of nine additional months may be built into the time period. Under the cash basis of accounting, the government must therefore wait until the third year to obtain the maximum financial impact.

8 See above, page 19.

■ A major effort at term

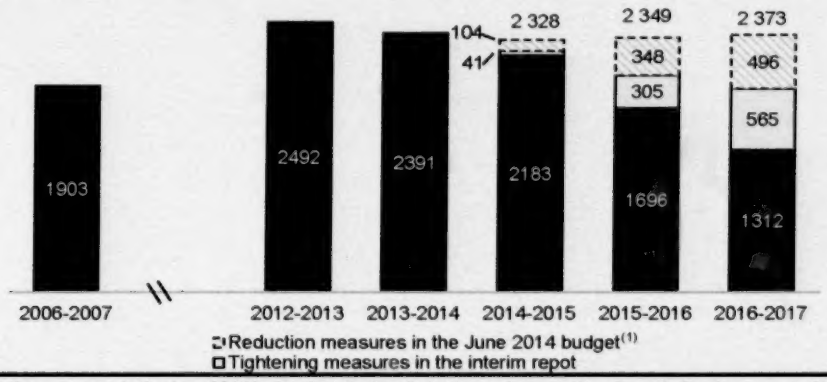
The measures to tighten tax expenditures pertaining to corporations would therefore build on those implemented as part of Budget 2014-2015.

In total, the measures recommended by the Québec Taxation Review Committee and the measures defined in Budget 2014-2015 represent a significant effort to tighten corporate tax expenditures. The measures are estimated at $653 million in 2015-2016 and $1.061 billion in 2016-2017.

In 2015-2016 and 2016-2017, a portion of the proposed tightening measures of $305 million and $565 million respectively would provide leeway for reducing certain corporate tax expenses, as part of the taxation reform to be proposed by the committee in its final report.

CHART 1

Impact of the proposed tightening measures on tax assistance for businesses
(millions of dollars)



(1) The reduction measures in the June 2014 budget include the elimination and suspension of certain fiscal measures, the 20% reduction in the rates of tax credits and the imposition of caps on fiscal measures pertaining to the capitalization of businesses.

2. A MEASURE TO TIGHTEN TAX EXPENDITURES PERTAINING TO CONSUMPTION TAXES

To meet the government's request, the Québec Taxation Review Committee identified a fifth tightening measure, one that concerns tax expenditures pertaining to consumption taxes.

❑ Standardize at 9% the rate of the tax levied on automobile insurance premiums

More specifically, the consumption tax tightening measure identified by the committee concerns the tax on insurance premiums.

■ Two exceptions

In Québec, insurance premiums are subject to the tax on insurance premiums at the general rate of 9%.

However, there are two exceptions constituting tax expenditures.

— Premiums on individual personal insurance, such as life, health or accident insurance, are exempt.

— A reduced rate of 5% is applied to premiums on automobile insurance for material damage.

■ Recommendation

The Québec Taxation Review Committee recommends that the exception respecting premiums on automobile insurance for material damage be eliminated, by raising the tax rate respecting such premiums from 5% to 9%.

This measure would standardize the tax rate applicable to all automobile insurance premiums, while maintaining the current exception for premiums on individual personal insurance. The measure would affect both individuals and corporations and would achieve its full effect as of 2015-2016.

❑ Savings generated

The proposed measure would generate savings of:

— $34 million in 2014-2015;

— $135 million in 2015-2016;

— $136 million on a recurring basis as of 2016-2017.

3. A TEMPORARY MEASURE CONCERNING INDIVIDUALS

A sixth tightening measure had to be identified to achieve the targets set. It is a temporary measure that would be in place only until the corporate mesures achieve their full effect. This sixth measure concerns individuals.

The temporary tightening measure identified by the Québec Taxation Review Committee with respect to individuals concerns the indexation of the main parameters of the personal income tax system.

❑ A temporary tightening measure identified by the committee

Indexation of the taxation system is intended to protect the purchasing power of Quebecers, who, year after year, must cope with rising consumer prices. Strictly speaking, indexation is not a tax expenditure. It does, however, raise the cost of the various tax expenditures that are indexed.

Historically, the personal income tax system has not always been indexed. When it was indexed, the method used by the government varied. Since 2002, the *Taxation Act* has provided for indexation of the main parameters of the personal income tax system. Currently, the indexation rate is calculated on the basis of the Québec consumer price index, excluding alcoholic beverages and tobacco products.

Québec has not always indexed its taxation system in the past. This was the case, for example, in the 1990s, when the government's aim was to balance the budget.

For these reasons, the committee broadened its analysis of possible tightening measures to include the indexation of taxation parameters.

Indexation of the main parameters of the personal income tax system

A taxation system that has not always been indexed

From 1990 to 2001, the personal income tax system was not fully indexed, even though the cost of living rose during that period.

- From 1990 to 1993, only the parameters pertaining to recognized essential needs were indexed.
- From 1994 to 2001, no parameters were indexed.

The main parameters of the personal income tax system were not indexed annually until 2002.

A method of indexation that has changed over time

The method has changed a number of times since annual indexation came into effect.

- In 2002 and 2003, indexation was calculated on the basis of the Québec consumer price index.
- In 2004, the rate was simply set at 2%.
- Since 2005, the method applied in 2002 and 2003 has been used, albeit excluding alcoholic beverages and tobacco products from the Québec consumer price index.
- Since 2008, the index has been rounded to the second decimal place.

Tax credit parameters subject to indexation have also changed over time, and the indexation of certain measures is recent.

Indexation of the main parameters of the personal income tax system (cont.)

Indexation is not the standard everywhere

Like the Québec system, the federal system has not always been indexed.

Elsewhere in Canada, three provinces do not index their taxation system—Prince Edward Island, Nova Scotia and Manitoba.

Indexing rates of federal and provincial personal income tax systems – 2006 to 2014
(per cent)

	2006	2007	2008	2009	2010	2011	2012	2013	2014
Federal[1]	2.2	2.2	1.9	2.5	0.6	1.4	2.8	2.0	0.9
Provinces									
Newfoundland and Labrador[2],[3]	—	1.0	1.1	2.8	0.7	2.0	3.1	2.6	1.5
Prince Edward Island[4]	—	—	—	—	—	—	—	—	—
Nova Scotia[5]	—	—	—	—	—	—	—	—	—
New Brunswick[1],[6]	2.2	2.2	1.9	2.5	2.0	2.0	2.8	2.0	0 9
Québec[7]	**2.43**	**.03**	**1.21**	**2.36**	**0.48**	**1.27**	**2.66**	**2.48**	**0.97**
Ontario[3]	2.2	2.1	1.5	2.3	0.7	1.8	3.3	1.8	1.0
Manitoba	—	—	—	—	—	—	—	—	—
Saskatchewan[1]	2.2	2.2	1.9	2.5	0.6	1.4	2.8	2.0	0.9
Alberta[3]	1.9	3.6	4.7	3.8	0.3	0.9	1.8	1.8	1.1
British Columbia[3]	2.1	1.9	1.8	2.	0.4	0.8	2.4	1.5	0.1

(1) The indexing rate is calculated according to the Canadian consumer price index.
(2) The indexing rate used for 2007 was 2.0%. However, indexation was applied only as of July 1, 2007. Accordingly, the effective rate for 2007 was 1.0%.
(3) The indexing rate is calculated according to the provincial consumer price index.
(4) In its 2007 budget, Prince Edward Island announced a rise of 2.0% for certain parameters of its taxation system for 2007 and 2008, including the basic amount and the taxable income bracket thresholds of the tax table.
(5) Nova Scotia stipulated a rise of $250 per year in its basic amount from 2006 to 2010. In addition, certain refundable tax credits were indexed in the same proportion as the rise in the basic amount. For example, the basic amount was increased by 3.23% in 2009 and 3.13% in 2010.
(6) The 2.0% rate for 2010 and 2011 was announced in December 2009.
(7) Since the 2005 taxation year, Québec's indexing rate has been based on the CPI-Québec, excluding alcoholic beverages and tobacco products.

Source: MINISTÈRE DES FINANCES DU QUÉBEC, *Parameters of the Personal income tax system for 2014*, November 2013.

❑ Recommendation

The Québec Taxation Review Committee is proposing a temporary measure to the government: Contrary to the preceding measures, the temporary measure would not apply until 2015 and would end in 2016; it would therefore not have a recurring impact.

The committee recommends that the indexation of the main parameters of the personal income tax system planned for 2015 be postponed by one year. In 2016, the parameters of the personal income tax system would be indexed at a rate that takes into account inflation calculated over two years.

The planned 2015 indexation would therefore clearly be postponed.

This recommendation affects the income thresholds of the tax table and the amounts relating to non-refundable tax credits. The recommendation does not concern the indexation of last resort assistance benefits, which should be maintained.

❑ Savings generated

The proposed measure would generate savings of:

— $58 million in 2014-2015;

— $194 million in 2015-2016;

— $13 million in 2016-2017 on a non-recurring basis.

4. AN ADDITIONAL REVENUE MEASURE

To achieve the targets set, the Québec Taxation Review Committee identified an additional revenue measure.

The seventh and final measure is intended as the last step in achieving the recurring savings targets of $150 million in 2014-2015 and $650 million in 2015-2016.

This measure pertains to consumption taxes, but does not constitute a tax expenditure tightening measure. The committee is proposing a revenue measure due to the difficulty of generating additional amounts in the short term solely through tax measures.

❑ Recommendation

The committee recommends that the current QST rate of 9.975% be increased to 10%.

This increase would not have a big impact on taxpayers.

❑ Additional revenues generated

The proposed measure would generate additional revenues of:

— $9 million in 2014-2015;

— $36 million in 2015-2016;

— $37 million on a recurring basis as 2016-2017.

SECTION 3:
IMPACT OF THE PROPOSED MEASURES

Together, the seven measures proposed enable the Québec Taxation Review Committee to achieve the objective of $650 million set by the government for fiscal year 2015-2016. For 2014-2015, the committee's proposals represent savings and additional revenues of $142 million, the bulk of the target for the current year.

TABLE 1

Savings and additional revenues generated by the proposed measures
(millions of dollars)

	2014-2015	2015-2016	2016-2017
Measures to tighten tax expenditures pertaining to corporations			
– In the case of large businesses, terminate full refundability of corporate tax credits	5	135	365
– Establish a minimum threshold respecting qualified expenditures for research and development tax credits and the investment tax credit	1	25	45
– Terminate the enhancement of the research and development tax credits for private partnerships, research consortiums and university research	0	15	25
– Terminate the reduction in the rate of the tax on capital of insurance corporations applicable to personal insurance premiums	35	130	130
Measures to tighten tax expenditures pertaining to consumption taxes			
– Standardize at 9% the rate of the tax levied on automobile insurance premiums	34	135	136
Temporary measure concerning individuals			
– Postpone by one year the planned 2015 indexation of the main parameters of the personal income tax system	58	194	13
Additional revenue measure			
– Increase the QST rate from 9.975% to 10%	9	36	37
TOTAL	**142**	**670**	**751**

❑ An effort that has the support of most corporations

For the current year, corporation-exclusive measures account for 29% of the amounts generated. However, that share will gradually increase to 46% in 2015-2016 and reach 75% at term when the full impact of the measures is felt. This does not take into account corporations' share of the measure to tighten automobile insurance premiums.

❑ Amounts generated

In 2015-2016, and especially as of 2016-2017, amounts in excess of the $650-million objective would be generated, estimated at $20 million the first year and $101 million subsequently.

These excess amounts would provide the committee with leeway it intends to use in the reform of the corporate taxation system, for example to revise the mix of taxation methods, which will be presented in its final report.

CONCLUSION

This report is the interim report requested by the government in the order in council creating the Québec Taxation Review Committee. As indicated in the introduction, this report is an integral part of the overall reflection undertaken by the committee.

❑ Work in progress

The Québec Taxation Review Committee wishes to inform the government of areas on which it is currently focusing its attention.

The committee is looking at tightening measures for combating the various kinds of tax evasion strategies devised for individuals and corporations. It has undertaken a comprehensive reflection on this issue.

The committee is systematically examining some 300 existing tax expenditures in the personal income tax, corporate tax and consumption tax systems. It has devised an evaluation grid based on a number of concerns and questions, so as to ensure that a careful examination is carried out.

The committee is paying special attention to the tax treatment of childcare services, in compliance with the component of its mandate pertaining to the assessment of the possibility of subjecting to taxation certain user fees, in order to take into account the ability to pay of users of public services, bearing in mind the impacts on the implicit marginal taxation rates.

❑ A three-pronged approach

The Québec Taxation Review Committee reiterates that, on the basis of its mandate, it is taking a three-pronged approach to targeting tax initiatives:

— immediate tightening of tax expenditures, dealt with in this report;

— reform of the Québec taxation system in the short, medium and long term that entails no costs for taxpayers as a whole and that is cost-neutral for public finances;

— once budget balance has been restored, identification of priority tax relief to be granted out of amounts that can be generated within the financial framework.

EXCERPT FROM THE FINAL REPORT: FUNDING OF REDUCED-CONTRIBUTION CHILDCARE SERVICES

QUÉBEC TAXATION REVIEW COMMITTEE

COVER LETTER FROM THE COMMITTEE

November 18, 2014

Mr. Carlos Leitão
Minister of Finance
Ministère des Finances
12, rue Saint-Louis
Québec

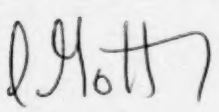
Dear Minister:

At your request, please find enclosed an excerpt from the future final report of the Québec Taxation Review Committee, relative to the funding of reduced-contribution childcare services. The excerpt is for your attention only, its having been agreed that the excerpt will not be released before the final report is tabled.

There is consensus within the committee on the position presented in the excerpt.

We hope that the report meets your expectations.

Yours truly,



Luc Godbout
Chair, Québec Taxation Review Committee

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1. ADAPTING THE FUNDING OF PUBLIC SERVICES IN A CHANGING SOCIETY

As part of its mandate, the Québec Taxation Review Committee was tasked with assessing the possibility of subjecting to taxation certain user fees, in order to take into account the ability to pay of users of public services, bearing in mind the impacts on the implicit marginal taxation rates.

1.1 The case of childcare services

The network of reduced-contribution childcare services has existed in Québec since 1997.

— The number of spaces has risen sharply over the years, even though it is still limited today.

— The number of spaces grew from more than 75 000 in 1997-1998 to nearly 225 000 on September 30, 2014.

— However, that number still falls short of demand.

The parental contribution was initially set at $5 per day.

— On January 1, 2004, the parental contribution was increased to $7 per day.

— On October 1, 2014, the parental contribution was set at $7.30 per day.

— The government announced that the parental contribution would be indexed annually according to the increase in the cost of the program. The new rate will apply as of September 1 each year.

Non-subsidized childcare spaces are also available to parents.

— In September 2014, the number of non-subsidized spaces was approximately 50 000.

The Québec government participates in funding childcare costs in both cases.

— In the case of reduced-contribution childcare services, the government's participation is direct, that is, the government subsidizes spaces to reduce the cost and parents pay only the regulatory reduced rate.

  — The government subsidy for childcare centres (CPEs) averaged $53.59 per day in 2013-2014, for a total cost of $60.16 including the parental contribution.[9]

  — The government subsidy paid to subsidized daycare centres averaged $43.19 per day in 2013-2014, for a total cost of $49.84 including the parental contribution.

  — The government subsidy for home childcare averaged $27.81 a day in 2013-2014, for a total coast of $33.75 per day including the parental contribution.

  — In total, these subsidies should reach $2.403 billion in 2014-2015.

9 The difference between the total cost and the average subsidy corresponds to the average parental contribution, which is less than $7 because recipients of last resort assistance programs are exempted from the parental contribution.

— In exchange for the subsidized rate, these childcare expenses are not eligible for the Québec refundable tax credit for childcare expenses.

— In the case of non-subsidized childcare, for which parents pay the full cost, the expenses incurred give entitlement to the Québec refundable tax credit for childcare expenses, the rate of which varies from 75% to 26% depending on family income.

  — The cost of this tax expenditure reached $557 million in 2013.

In both cases, the fees paid by parents are eligible for the federal child care expenses deduction.

— The childcare rate paid by parents is eligible for the federal deduction.

— In the case of non-subsidized childcare services, the full childcare rate is eligible for the federal deduction, regardless of the refund obtained through the Québec refundable tax credit for childcare expenses.

  — For a space costing over $27 per day, the value of the annual deduction can be up to $7 000 per child under 7 years of age.

  — As of 2015, the deduction limit will be raised to $8 000 per child under 7 years of age, which corresponds to a daily cost of approximately $31.

— In the case of a reduced-rate space, only the rate actually paid by parents is eligible for the federal deduction.

  — Thus, the very design of the funding of the reduced-contribution childcare network reduces the federal contribution to funding the network by limiting the value of the federal deduction to the low daily rate payable by parents.

  — By setting the rate at $7.30 a day, the annual federal deduction reaches at most $1 898 per child.

  — Compared with the other provinces, Québec society is depriving itself of more than one hundred million dollars in federal assistance for families.

  — For example, the average child care expenses deduction claimed by Québec taxpayers was $2 311 in 2011, compared with $4 560 for Ontario taxpayers.[10]

— In addition to its direct value, which reduces income tax payable, the deduction raises the amount paid to families under certain federal socio-fiscal transfers reducible on the basis of income.

  — Taking the deduction into account reduces the net family income used to calculate the transfers, such as the Universal Child Care Benefit (UCCB) and the GST credit.

  — The larger the deductible amount, the more net income declines, increasing the number of families eligible and the value of the transfers. Conversely, limiting the deductible amount, as in the case of the rate paid in the reduced-contribution network, decreases both the number of families eligible for the transfers and the value of the transfers for eligible families.

10 CANADA REVENUE AGENCY, *Income Statistics 2013 (2011 tax year)*, May 2014, Table 5.

— This dual impact must be factored into the calculation of the net cost of childcare spaces.

❑ Funding of reduced-contribution spaces and long-term survival of the network

From a public finance standpoint, the current network of reduced-contribution spaces represents a rising cost for the government.

— Total subsidies will rise from $1.338 billion in 2003-2004 to $2.403 billion[11] in 2014-2015.

Three main reasons explain this increase in the cost of subsidies to the reduced-contribution network.

— First, the parental contribution was not indexed regularly, so the share funded by parents fell significantly, even taking into account the adjustment in 2014.

  — When the reduced-contribution network was set up in 1997, the reduced rate of $5 paid by parents accounted for approximately 20% of the total cost.

  — That share represented 17.2% in 2004-2005.

  — At the current rate, the parental contribution represents only 13.6% of the total cost in 2014-2015.

— Second, the increase in the number of subsidized spaces to meet demand puts pressure on the cost of the program.

— Lastly, the per-space cost, even in constant dollars, has risen.

This growth in cost puts pressure on the long-term survival of the network and the development of new spaces.

Furthermore, the reduced-contribution network is not actually available to all parents who would like to use it.

— There is still a gap between the demand for spaces and the available supply.

— The impossibility for some parents to use the reduced-contribution network creates unfairness.

11 Forecast.

1.2 Revision of the method of funding reduced-contribution childcare services by subjecting childcare rates to taxation

The purpose of the revision is first and foremost to ensure the long-term survival of the reduced-contribution childcare network.

— This is reflected in the Québec Taxation Review Committee's concern that the cost not be raised for most families, even that it be reduced, particularly for low- and middle-income households.

The foundations of the network are not at issue; rather, a revision of the funding method is called for.

— The committee fully recognizes the positive externalities of the reduced-contribution childcare network, such as women's access to, and retention of women in, the labour market, and better school success for disadvantaged or special needs children.

— Québec society must continue to reap the benefits of these externalities through maintenance of the network.

— The committee considered revision on the basis of three guidelines.

  — The first guideline concerns the manner of taking into account the ability to pay, according to the option chosen for subjecting childcare rates to taxation.

    – The uniform increase imposed by maintaining the present universal rate schedule, without subjecting rates to taxation, hinders accessibility.

    – Subjecting rates to taxation enables families' ability to pay to be taken into account and greater vertical fairness to be achieved.

    – Subjecting rates to taxation enables the gross parental contribution to be increased while maintaining a low net cost for low- and middle-income families but imposing a progressive net cost on families with higher incomes.

  — The second guideline concerns fairness between the two existing networks.

    – A revised funding method must lead to greater fairness between families using the subsidized network and those using the non-subsidized network.

    – It is matter of making funding more neutral, so as to minimize the net cost difference between the two networks.

  — The third guideline concerns correction of the design flaws in the funding of the system, which deprive Québec of a significant financial contribution from the federal government.

    – The funding method must lead to better use of the federal child care expenses deduction, by raising the amounts Québec parents receive for childcare expenses.

The committee evaluated three rate scenarios:

— maintenance of the current funding method, with a uniform rate increase;

— subjecting childcare rates to taxation through payment of an additional rate on filing an income tax return;

— subjecting childcare rates to taxation through eligibility for an enhanced Québec tax credit for childcare expenses.

— After examining these scenarios, and in light of the aforementioned guidelines, the Québec Taxation Review Committee recommends the third scenario—subjecting childcare rates to taxation through eligibility for an enhanced tax credit for childcare expenses.

■ Recommended scenario: Subjecting childcare rates to taxation through eligibility for an enhanced tax credit for childcare expenses

— The goal of this scenario is to provide families with access to childcare at the lowest possible net rate, depending on their ability to pay, while minimizing the subsidy payable by the government.

— The single rate charged is just one variable in determining the net cost borne by families.

– The portion refunded by the Québec tax credit and the federal deduction amounts are the other two variables that determine the net cost actually borne by families.

– The proposed revision touches on each of these three variables.

— Compared with the current situation, this revision of childcare funding would:

— reduce the net cost of childcare spaces for families with an income below approximately $110 000:

– Given that the median income of single-parent families is $30 800, most of the families would see a decrease in their net childcare cost per day. At $120 000 in annual income, the increase in the net childcare cost would be barely $0.61;

– The median family income of two-parent families is $81 800, a level at which the net rate is lower than the current net rate. At $120 000 in annual family income, the increase in the net childcare cost would be only $1.04;

— generate annual savings of $263 million for the Québec government through:

– an income-based increase of $114 million in the net cost for families;

– an increase in the contribution of the federal government further to the application of the child care expenses deduction and its impact on certain socio-fiscal transfers, for an annual amount of $149 million.[12]

12 Including the announcements made by the federal government on October 30, 2014—income splitting for families, the increase in the monthly UCCB payment from $100 to $160 per child under 6 years of age and the increase from $7 000 to $8 000 in the limit on the federal child care expenses deduction for these families.

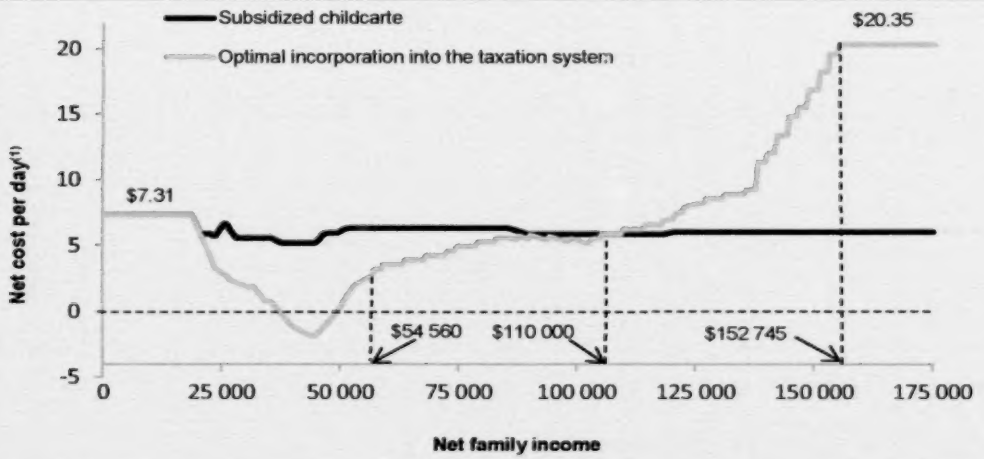
— The following chart illustrates the net cost, based on family income, for a family with one child and two equal incomes.

  - The net cost is initially invariable, then drops as of a net income of approximately $120 000. This is due to the federal deduction, which has no impact in the absence of income tax payable.

  - As of a family income of approximately $40 000 a year, the net cost gradually rises based on income, but remains below the current cost up to a family income of roughly $110 000, the point at which the two curves intersect.

CHART 1

Illustration of the net cost per day in the current situation and according to the recommended scenario for a couple with one child and two equal incomes — 2015
(dollars)



(1) Including federal taxation.

The scenario proposed by the Québec Taxation Review Commitee consists in setting the gross rate, before tax compensation, at $35 and qualifying it for the enhanced Québec deduction for childcare expenses. The rate would subsequently be indexed annually. It does not represent the actual cost borne by families, since they would receive assistance from both the Québec and federal governments.

— The Québec tax credit for childcare expenses would be increased from 75% to 80% for low-income families and maintained at that level up to a family income of $54 625.

— The rate would give entitlement to the maximum amount of the federal child care expenses deduction.

  — The subsidy paid for reduced-contribution childcare spaces would then be reduced, in order to maintain the current level of funding per space.

In addition to these benefits, the scenario would lower the cost of childcare services for low- and middle-income families who do not have access to spaces in the subsidized network.

— The increase in the refundable tax credit for childcare expenses would apply to both families using the subsidized network and those using the non-subsidized network.

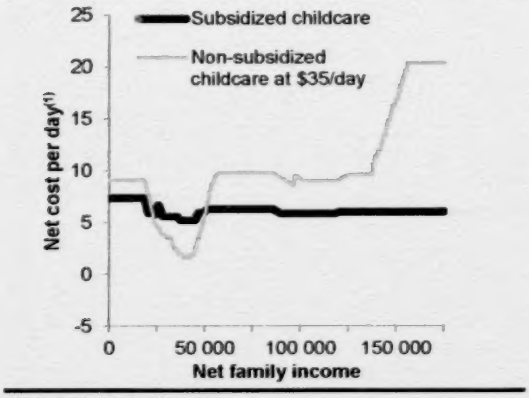
Similarly, the scenario would result in greater neutrality between the subsidized network and the non-subsidized network.

— Without subjecting childcare rates to taxation, application of the single rate creates situations in which some families pay more for a subsidized space than do families for a non-subsidized space, because of the tax benefits that may be claimed with respect to the non-subsidized space. In other cases, a non-subsidized space can cost significantly more than a subsidized space, despite the applicable tax benefits.

— Subjecting childcare rates to taxation as proposed means that the net cost of a $35 space in the non-subsidized network becomes equivalent to the cost of a subsidized space.

CHART 2

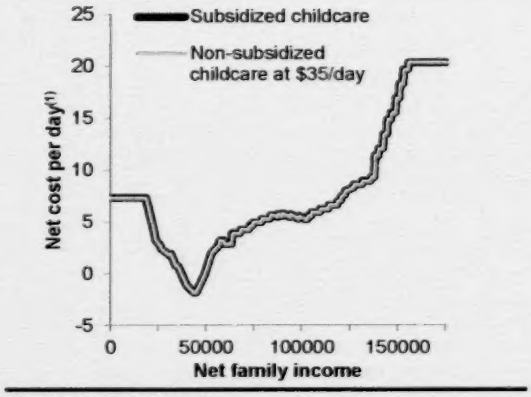
Current net cost[1] of subsidized and non-subsidized childcare
(dollars)



(1) Including federal taxation.

CHART 3

Proposed net cost[1] of subsidized and non-subsidized childcare
(dollars)



(1) Including federal taxation.

The scenario would not have a significant negative impact on the problem posed by METRs.[13]

— The Québec Taxation Review Committee made sure that the credit rate would be reduced slowly based on income, particularly in the revenue bracket most affected by the problem posed by METRs.

— The rate of the refundable tax credit for childcare expenses having been set at 80% up to a family income of $54 625 is a contributing factor.

However, the impact for families of having to pay a higher gross rate, which can cause some of them cash-flow problems, must be taken into account in implementating the scenario.

— Families whose children attend non-subsidized daycare centres already experience this.

— In that regard, Québec has already put in place a system of monthly advance payments of the tax credit for childcare expenses.

— This system must be adapted to reach more recipients of the tax credit, in order to ensure that all families affected by the change may take advantage of the system as soon as the change comes into effect.

13 The marginal effective tax rate (METR) measures the net tax burden for a variation in income at a particular income level. In addition to income tax, this measurement takes into account the variation of all contributions paid, and the benefits received, by a taxpayer.

❑ Other scenarios evaluated

The Québec Taxation Review Committee evaluated two other scenarios:

— maintenance of the current funding method, with a uniform rate increase;

— subjecting childcare rates to taxation through payment of an additional rate on filing an income tax return.

■ Scenario involving a uniform rate increase

Under this scenario, there would be no change to the current system apart from a uniform increase in the applicable rate, which would not be subject to taxation, followed by annual indexation of the rate, as is currently the case.

— To obtain a total additional contribution from families equivalent to that under the scenario recommended by the Québec Taxation Review Committee, the universal rate would have to be raised to $9.75 per day.

The subsidy paid for a reduced-contribution childcare space would then be reduced to maintain per-space funding at the current level.

Compared with the recommended scenario, this scenario would generate much smaller savings—$130 million—for the Québec government, while imposing an equivalent additional burden on all families ($113 million), this time without taking their income into account.

— Under this scenario, all families would see an increase in the net cost of childcare spaces, regardless of their ability to pay and with no compensation mechanism for low-income families.

  — For single-parent families with an annual income of $30 000, this would mean a $1.78 increase in the net childcare cost, compared with a decrease of $3.06 in the recommended scenario.

  — For two-parent families with an annual family income of $75 000, the increase in the net childcare cost would be $2.02, compared with a decrease of $1.39 in the recommended scenario.

This scenario would have the advantage of being easy to implement, since it involves simply raising the single rate. However, as a result, all families, whether their income is modest or high, would bear the same rate increase.

This scenario would have no impact on METRs, since it involves a single rate irrespective of income.

- **Scenario in which childcare rates are subject to taxation through payment of an additional rate on filing an income tax return**

Under this scenario, the net cost of reduced-contribution childcare services would be increased based on income.

The initial rate paid by families would remain unchanged, but an additional rate would be calculated on filing an income tax return.[14]

— *The maximum rate would reach $15 per day as of a family income of approximately $130 000.*

— In the case of a single-parent family with a family income under $34 280, or a couple with a child and a family income under $47 189, the current rate would continue to apply.

— Between these two incomes, the additional rate calculated on the income tax return would increase linearly.

— Neither the initial rate nor the additional rate would be eligible for the Québec refundable tax credit for childcare expenses.

The subsidy paid for a reduced-contribution childcare space would not change, but the revenue from the addtional rate would serve to finance the subsidy.

This scenario would generate savings of $170 million for the Québec government, financed primarily by families ($130 million), but on the basis of their income.

— Contrary to the scenario involving a uniform rate increase, low-income families would have protection.

— However, compared with the recommended scenario, no families, not even low-income families, would see a reduction of their net cost.

— In the case of single-parent families with an annual income of $30 000, the net childcare cost would be unchanged, compared with a $3.06 decrease under the recommended scenario and a $1.78 rise under the uniform-increase scenario.

— In the case of two-parent families with an annual family income of $75 000, the $2.01 increase in the net childcare cost would be more or less equivalent to the uniform-increase scenario ($2.02). Conversely, the recommended scenario would enable these same families to save $1.39.

This scenario could be implemented relatively easily.

— This scenario would require taking into account a cash-flow impact different from the one in the recommended scenario: Without adequate planning by families, some might have to make a substantial payment on filing their income tax return.

  — To mitigate this risk, source deductions will have to be adapted to take this rate into account.

14 The government would have to ensure that the additional rate is recognized by the federal government as being being eligible for the deduction for child care expenses.

— There would be an impact on METRs, but it would be limited by the proposed threshold, as of which the additional rate would be payable progressively.

  — The income as of which the rate would increase corresponds to the cut-off threshold for the work premium.

❑ Comparison of the three scenarios

Only the recommended scenario would result in a cost reduction for low- and middle-income *families.*

— The scenario in which childcare rates are subject to taxation on filing an income tax return would protect only low-income families, compared with the uniform-increase scenario, and would not result in a cost reduction for any families.

— The uniform-increase scenario would affect all families irrespective of their ability to pay.

The recommended scenario is the one that would enable the government to generate savings with a minimum impact on families, that impact being felt only by families with the highest incomes.

The recommended scenario is the only one that would correct the design flaw in the current funding of the network, with a view to recovering the available federal share of funding.

The recommended scenario would make subsidized and non-subsidized spaces more cost-neutral.

— The scenario involving payment of an additional rate on filing an income tax return would also narrow the gap in the cost between the two networks, although to a lesser extent.

However, more extensive planning would be required to implement the recommended scenario, in order to adequately take into account the contraints connected with the cash-flow needs of families.

The scenario involving payment of an additional rate on filing an income tax return would require the government to ensure that the additional rate is recognized by the federal government as being eligible for the deduction for child care expenses.

TABLE 1

Impact of the scenarios evaluated on families' disposable income, compared with current rates – Family with a 3-year-old child
(dollars per year)

	Single-parent family			Couple with two equal incomes		
Work income	**Recommended scenario**	**Uniform increase**	**Income-based rate**	**Recommended scenario**	**Uniform increase**	**Income-based rate**
30 000	**794**	–464	—	**956**	–464	—
50 000	**1 679**	–460	–202	**1 482**	–496	–11
75 000	**718**	–491	–630	**362**	–527	–522
100 000	**381**	–470	–997	**132**	–491	–962
120 000	**–159**	–470	–1 313	**–272**	–491	–1 343
140 000	**–1 361**	–482	–1 511	**–1 564**	–503	–1 584
180 000	**–3 369**	–467	–1 501	**–3 704**	–483	–1 597

TABLE 2

Overall financial impact of the scenarios examined
(millions of dollars)

	Recommended scenario	Uniform increase	Income-based rate
Total impact for the Québec government	263	130	170
Net impact for families	–114[1]	–113	–130
Impact for the federal government (child care expenses deduction and impact on socio-fiscal transfers)	–149	–17	–40

(1) Including relief of $50 million for families using private childcare services who would benefit from the increase in the tax credit for childcare expenses. The net impact solely for families using subsidized childcare would thus be $164 million.

1.3 Childcare at school

❑ Current system

The reduced-contribution childcare network also exists in schools.

— This network is for a clientele attending school that is separate from the preschool childcare clientele.

  — Childcare at school is a service generally used outside school hours—in the morning before school starts, on the lunch hour and after school, as well as on pedagogical days.

— Contrary to preschool childcare services, there is no accessibility problem with respect to childcare provided at school.

— Childcare at school differs from childcare offered at CPEs. For example:

  — childcare at school is offered for a maximum of 5 hours per day, except on pedagogical days, compared with a maximum of 10 hours at CPEs;

  — snacks and lunch are not provided at schools, contrary to CPEs;

  — childcare at school is offered on a basis of 180 days (200 days with pedagogical days), compared with 260 days at CPEs.

— The situation is different for parents of children who are in childcare at school, because they pay a substantial part of the daily rates.

  — For the 2013-2014 school year, parents covered 55% of total funding for school childcare.

— Since the creation of the service, the parental contribution per day for childcare at school has been the same as for preschool childcare.

  — The contribution was initially set at $5 per day.

  — On January 1, 2004, the parental contribution was increased to $7 per day.

  — On October 1, 2014, the parental contribution was set at $7.30 per day.

  — The government announced that the parental contribution would be indexed annually according to the increase in the cost of the program. The new rate will apply as of September 1 each year.

— The government subsidy is much lower.

  — The government subsidy for childcare at school averaged $5.73 in 2013-2014, for a total cost of $12.73 including the parental contribution.

- **A revision of the method of funding childcare at school consistent with the specific nature of the service**

The revision of the funding method proposed by the Québec Taxation Review Committee with respect to reduced-contribution childcare services cannot be applied directly to childcare services at school, because:

— the per-space cost is much lower due to the very different nature of the service offered;

— a larger portion is already covered by parents.

The committee recommmends that revision in keeping with the principle of taxation but adapted to the specific nature of childcare at school be applied.

— Parents would initially be billed for the full rate of $12.73.

— A new tax credit styled on the tax credit for preschool childcare services would be granted with respect to these expenses in order to reduce their cost.

  — The parameters of the new credit would, however, be adjusted so that the parental contribution varies with income, but at no cost to the government and families as a whole.

  — As in the scenario recommended for reduced-contribution childcare services, families with a family income under approximately $110 000 would not pay more than they currently do, and a large percentage of them would see a reduction in their net cost. For families with an income over $110 000, the net cost would rise according to income.

  — Thus, low- and middle-income families would see a reduction in their net cost, and the cost would rise only for families with a higher income.

❑ Caveats

Finally, the Québec Taxation Review Committee wishes to emphasize how sensitive this file is.

— The childcare rates file, with respect to both reduced-contribution childcare services and childcare at school, raises certain concerns.

— Proper administrative preparation is necessary to ensure that everything runs smoothly when the change is implemented.

  — For example, the system for advance payments of the tax credit must be adjusted to accommodate additional applications.

  — In addition, adjustment of the federal source deduction for persons who pay childcare expenses must be facilitated.

— In the committee's view, the main risk is underestimating the difficulties involved in implementing major changes, for example by effecting them in haste.

— Implementing the changes proposed by the committee requires that the necessary time and effort be put into properly explaining the impact on households according to their financial situation. The advantages are significant:

  — ensuring the long-term survival of the network;

  — making sure the resulting positive externalities, such as women's access to, and retention of women in, the labour market, are capitalized on;

  — taking into account families' ability to pay, in order to protect low- and middle-income families by granting them a reduction in their net cost;

  — correcting the design flaw in the funding of the network, which deprives Québec society of over one hundred million dollars in family assistance from the federal government;

  — improving fairness between families using the subsidized network and those using the non-subsidized network, through more neutral funding of the two networks.

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